

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
CHENG KAI YU AND HUI HUI YU	:	DETERMINATION
for Redetermination of a Deficiency or for	:	
Refund of New York State Personal Income Tax	:	
under Article 22 of the Tax Law and New York	:	
City Personal Income Tax under Chapter 46,	:	
Title T of the Administrative Code of the City	:	
of New York for the Years 1984 and 1985.	:	

Petitioners, Cheng Kai Yu and Hui Hui Yu, 903 Ocean Avenue, Brooklyn, New York 11226, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law and New York City personal income tax under Chapter 46, Title T of the Administrative Code of the City of New York for the years 1984 and 1985 (File No. 806696).

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on September 20, 1990 at 9:45 A.M., with all briefs to be submitted by November 30, 1990. Petitioner Hui Hui Yu appeared pro se and on behalf of her husband, Cheng Kai Yu. The Division of Taxation appeared by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel).

ISSUE

Whether the Division of Taxation, upon audit, properly determined additional personal income tax to be due from petitioners for the years 1984 and 1985.

FINDINGS OF FACT

Petitioners, Cheng Kai Yu and Hui Hui Yu, husband and wife, reside at 903 Ocean Avenue, Brooklyn, New York. This is also the same address as that of a professional corporation known as Cheng Kai Yu, M.D., P.C. (the "corporation"). Petitioner Cheng Kai Yu, a physician, is the sole shareholder of and is employed by Cheng Kai Yu, M.D., P.C.

On or about October 9, 1987, the Division of Taxation conducted a field audit examination of petitioners' personal income tax returns for the years 1984 and 1985 and of the corporation's books, records and returns for its (related) fiscal years ended September 30, 1984, 1985 and 1986. The results of this field audit examination were summarized in a Statement of Personal Income Tax Audit Changes, issued to petitioners on November 17, 1987. This statement reflected a number of adjustments to petitioners' personal income tax returns for 1984 and 1985, including an increase to petitioner Cheng Kai Yu's income by the amount of \$10,000.00 for each of the years 1984 and 1985. In addition, a portion of petitioners' medical expenses for each of the years in question were disallowed, a PASS fund deduction for 1985 was disallowed, and the amounts of certain professional corporation modifications relating to social security and pension items (see Tax Law § 612[b]) for each of the years in question were adjusted. Finally, an investment credit relating to the purchase of a computer and claimed child care credits for each of the years in question were disallowed.

For each of the years 1984 and 1985, petitioners filed a New York State and City of New York Resident Income Tax Return (Form IT-201) in a timely fashion. Each of these returns reflects the choice of filing status "2" ("married filing joint return"). These returns do not report any income or compensation received by petitioner Hui Hui Yu for either of the years in question, while wages, salaries, tips, etc. of \$40,000.00 were reported for petitioner Cheng Kai Yu for each year. Wage and tax statements (forms W-2) attached to each of these returns indicate, inter alia, wages, tips and other compensation in the amount of \$40,000.00 paid by the professional corporation to Cheng Kai Yu as employee.

Petitioners specified at hearing that the only items remaining in dispute were the \$10,000.00 increase to income for each year and the disallowed child care credits. Petitioners conceded that the balance of the adjustments were proper and were not in dispute.¹

As to the two items remaining in question, the \$10,000.00 increase to petitioners' adjusted gross income for each of the years at issue results directly from a review of the professional corporation's tax reports (Forms CT-3). Schedule F on such reports, listing salary and compensation of officers, reflects \$50,000.00 as salary and compensation paid to petitioner Cheng Kai Yu as president of the professional corporation. By contrast, however, petitioner

¹Certain of the adjustments agreed to, such as the professional corporation modifications and the disallowed portion of medical expenses, involve simply a mathematical change determined largely as a function of adjusted gross income.

Cheng Kai Yu reported only \$40,000.00 of wages, tips and compensation as shown on Forms W-2 issued by the corporation and attached to petitioners' returns. The Division of Taxation raised no question as to the propriety of the corporation having deducted the full \$50,000.00 amount reported as salary and compensation on its Forms CT-3. As to the disallowed child care credits, the Division noted that petitioner Hui Hui Yu reported no salary or compensation received for either of the years in question.

On February 23, 1988 the Division of Taxation issued a Notice of Deficiency to petitioners, Cheng Kai Yu and Hui Hui Yu, asserting additional personal income tax due for the years 1984 and 1985 in the aggregate amount of \$3,035.91, plus penalty (Tax Law § 685[b]) and interest. This aggregate amount of tax due matches the aggregate amount shown as due on the Statement of Audit Changes, broken down on the latter document, however, between each of the years in question and further between New York State and New York City amounts for each of such years.

Petitioner Hui Hui Yu testified at hearing that the child care credit was claimed upon the basis that she was "looking for work and needed child care, even though she received no compensation in either of the years 1984 or 1985." The nature of the work sought by Mrs. Yu was not specified, nor were any details furnished as to the nature of her search for work.

Petitioner Hui Hui Yu testified that she prepares the books and records for the professional corporation, obtaining help, as necessary, from an accountant. As to the \$10,000.00 increase in income, petitioners allege that such amount represents "fringe benefits" or expenses paid on behalf of petitioner Cheng Kai Yu by the corporation, but do not represent income to petitioner Cheng Kai Yu. Mrs. Yu testified that the amount included "an educational plan and some other kinds of fringe benefits not directly paid to the individual." Petitioners allege said expenses to represent items properly paid and expensed by the professional corporation but not representing income to petitioner Cheng Kai Yu. No further specifics were given as to the nature or amounts of the various items comprising the \$10,000.00 amount for either year, other than the explanation that "the corporation pays certain bills for Dr. Yu," and that such payments "are not taxable under Internal Revenue Service rules and regulations." Petitioners also argued that since the Division found no error in the corporation's returns (i.e., that the deductibility of the full \$50,000.00 amount was not challenged) and since the corporation furnished the Forms W-2 to the individual petitioner (Cheng Kai Yu), the W-2 was properly used as a basis for preparing the personal income tax returns in question and any error belongs to the corporation but not to the individuals.

CONCLUSIONS OF LAW

A. The Division of Taxation properly disallowed the claimed child care credits. In order

to qualify for such credit, the employment related expenses upon which the credit is calculated may not, in the case of married taxpayers, exceed the lesser of either spouse's earned income. Since petitioner Hui Hui Yu had no earned income for either of the years in question, the employment related expenses upon which the credit is calculated would be zero and no credit results (see, Tax Law § 606[c]; I.R.C. § 21).

B. Petitioners have failed to sustain their burden of proving that the additional \$10,000.00 for each year did not represent compensation to petitioner Cheng Kai Yu. More specifically, the corporation tax reports for the periods in question clearly indicate compensation paid to Dr. Yu which was \$10,000.00 more than the amount reported on petitioners' personal income tax returns for each of the subject years. It could be argued that some or all of the \$10,000.00 amount represented expenses properly paid by the corporation which did not, in turn, constitute taxable compensation to petitioner Cheng Kai Yu. However, petitioners have offered no proof to establish the same. Without any evidence to the contrary, it is equally likely that such amounts represented either additional amounts paid by the corporation which properly constituted compensation to Cheng Kai Yu or, on the other hand, represented the corporation's payment of personal expenses properly deemed a constructive dividend paid by the professional corporation to its sole shareholder, Cheng Kai Yu. The fact that the Division of Taxation did not challenge the propriety of deducting the full \$50,000.00

amount at the corporation level is of no moment in the determination that the \$10,000.00 difference between the corporation's reporting of compensation versus the amount of compensation reported on petitioners' personal income tax returns represented taxable compensation to Cheng Kai Yu. At worst, this merely represents the Division's acceptance that such amount was not a constructive dividend. In sum, absent evidence to establish the nature and amounts of the particular items comprising the \$10,000.00 difference, petitioners have failed to meet the burden of proving that the full amount in question did not represent additional compensation received by Cheng Kai Yu as reported on the professional corporation's Forms CT-3.²

C. The petition of Cheng Kai Yu and Hui Hui Yu is hereby denied and the Notice of Deficiency dated February 23, 1988, together with such penalty and interest as is lawfully due and owing, is sustained.

DATED: Troy, New York

2/22/91

ADMINISTRATIVE LAW JUDGE

²Petitioners' argument that they were entitled to simply rely on the Forms W-2 in preparing their returns and that any error thereon should be addressed at the corporate level loses force when it is remembered that petitioner Hui Hui Yu prepares the books and records of the professional corporation including, presumably, the Forms W-2 it issues.